STAFF PAPER

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REG IASB Meeting

Project	**Conceptual Framework**
Paper topic	Cover paper for Section 3— Additional guidance to support the asset and liability definitions

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Background

1. This paper provides background information on Agenda Paper 10C(a) *Draft Discussion Paper: Section 3—Additional guidance to support the asset and liability definitions*.

2. Agenda Paper 10C(a) is a redraft of material from three previous papers:

   - February 2013 Agenda Paper 3B—*Elements of Financial Statements* (Part of that paper)
   - February 2013 Agenda Paper 3C—*Liabilities: impact of future events*
   - March 2013 Agenda Paper 5C—*Economic compulsion, constructive obligations and contractual obligations*

3. The material taken from these papers has been reordered under topic headings and updated to reflect comments made during the meetings.

4. This paper:

   (a) summarises the main changes to the content taken from the three previous papers; and

   (b) sets out questions for the Board.

Main changes

5. The main changes made to the content are as follows:

   (a) a new section overview.

   (b) an additional paragraph at the start of some of the topics to explain why the Board proposes to add more guidance on that topic—see paragraphs 2, 17 and 32.

   (c) additional guidance on resources that comprise bundles of rights, and resources that contain both rights and obligations—see paragraphs 10-12. The additional guidance clarifies, among other things, that entities would typically describe such assets using understandable terms (such as 'machine') rather than in terms of the various rights making up that asset.

   (d) clarification of one case in which an entity has an obligation 'to transfer an economic resource'—if it will settle its obligation by accepting a second obligation, and that second obligation requires the entity to transfer an economic resource—see paragraph 34.

   (e) addition of a preliminary view on constructive obligations—see paragraph 59. The discussion paper considers the possibility of narrowing the definition of a liability to include only obligations that are enforceable by legal or equivalent means. But it concludes that the Board tentatively favours retaining the existing definition of a liability—which encompasses both legal and constructive obligations—and adding more guidance to help distinguish constructive obligations from economic compulsion.

(f) clarification of the status of the examples in the section—see paragraph 66. They are included to help illustrate the problems and possible consequences of different solutions. The Board does not plan to reproduce the examples in the Conceptual Framework. Neither will it necessarily change existing requirements for transactions illustrated in the examples—any decision to amend an existing IFRS would require the Board to go through its normal processes…

(g) a revised description of 'Approach 2', the second of three possible approaches for addressing future events. This is the most significant change in the section. It is explained further below.

(h) an updated analysis of the role of economic compulsion in identifying contractual obligations—see paragraphs 84-89. The updates acknowledge that the options described in the example in paragraph 85 may have commercial substance. The updates also incorporate the Board's comments at the March 2013 meeting, ie that:

   (i) it might also be appropriate to take economic compulsion or significant economic incentives into account in determining whether a claim against the entity is a liability or part of equity, but

   (ii) the Board should consider any further requirements or guidance on the role of economic compulsion in identifying contractual obligations when developing individual IFRSs, not in the Conceptual Framework.

Impact of future events—revised description of Approach 2

6. Paragraphs 65-77 discuss whether an entity has a present obligation if the eventual need to transfer an economic resource depends on the entity's future actions. These paragraphs develop three possible approaches for assessing such situations.

7. The first approach (Approach 1) would state that a liability must be unconditional—an entity does not have a present obligation if it can avoid the transfer of resources through its future actions.

8. The second approach (Approach 2), as described in the February 2013 board papers, would modify the first approach and identify a liability if either the entity has an unconditional obligation or:

   (a) an obligation that accumulates over time or as the entity receives goods or services has already started to accumulate; and

   (b) although there is a theoretical possibility that a final condition will not be met, that possibility is not a realistic one.

9. Several Board members expressed support for the aims of Approach 2. However, some expressed concerns that:

   (a) the approach appeared to lack a clear underlying principle; and

   (b) the reference to the ‘possibility’ of the final condition not being met implied a probability threshold.

10. Some Board members suggested that the approach should focus on the timing of the exchange—a liability arises when an entity receives something for which it will have to make payment in exchange. It will have to make a payment if it has no practical ability to avoid the payment.

11. Taking into account these suggestions, the staff have revised the description of Approach 2. The revised description of the approach is in paragraphs 69-73 of Agenda Paper 10C(a). It would identify a liability at the earlier of the two following times:

    (a) when the entity incurs an unconditional obligation to transfer an economic resource; or

    (b) when the entity receives benefits in exchange for which it accepts a responsibility to transfer an economic resource.

12. Additional guidance could clarify that, if an entity receives benefits before it incurs an unconditional obligation, judgement would be required to determine whether it has accepted a responsibility to transfer an economic resource in exchange. Indications that the entity has accepted such a responsibility might be, for example, that:

    (a) the entity does not have the practical ability to avoid the future actions that would make the obligation unconditional;

    (b) the possibility that the entity will avoid the future actions has no discernible effect of the pricing of the transaction; or

    (c) the entity cannot avoid the future actions if it remains a going concern.

Questions

Questions for the Board

1	For the discussion on obligations whose outcome depends on the entity's future actions:
(a)	do you support the revisions to the description of Approach 2 (see paragraphs 69-73)?
(b)	do you have a preliminary view as to which of the three approaches (described in paragraphs 68-77) should form the basis of guidance in the Conceptual Framework?
2	Do you have any comments on any other aspects of this section of the draft discussion paper?
3	Do you have any comments on the proposed questions for respondents to the discussion paper (paragraph 95-98)?